



Treasury Inspector General for Tax Administration

THE INTERNAL REVENUE PAY-FOR-PERFORMANCE SYSTEM MAY NOT SUPPORT INITIATIVES TO RECRUIT, RETAIN, AND MOTIVATE FUTURE LEADERS

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Highlights

Highlights of Report Number: 2007-10-106 to the Chief Human Capital Officer.

IMPACT ON TAXPAYERS

The Internal Revenue Pay-for-Performance System may not support the positive impacts of the Internal Revenue Service (IRS) human capital initiatives to recruit, retain, and motivate future leaders. In addition, the new System was not adequately communicated to the managers before it was implemented, causing opposition and decreasing morale. As a result, the IRS risks reducing the ability to provide quality service to taxpayers because the Internal Revenue Pay-for-Performance System potentially hinders the IRS' ability to recruit, retain, and motivate highly skilled leaders.

WHY TIGTA DID THE AUDIT

This audit was initiated because the IRS faces significant challenges resulting from the potential loss of highly skilled technical managers and employees due to pending retirements. To maintain the continuity of its leadership and workforce, the IRS must ensure its managerial compensation system effectively attracts and retains high-performing individuals from both inside and outside the IRS and provides greater flexibility to reward and motivate high levels of performance.

The overall objective of this review was to determine whether the Internal Revenue Pay-for-Performance System effectively links compensation to individual performance. TIGTA focused its efforts on how the IRS implemented the System for managers and whether the IRS complied with the Personnel Flexibilities provisions of the IRS Restructuring and Reform Act of 1998 and the *Office of Personnel Management Criteria for IRS Broadbanding System*. TIGTA also evaluated potential risks to ongoing human capital initiatives to recruit, retain, and motivate future IRS leaders.

WHAT TIGTA FOUND

The IRS did not use the authority granted by the Restructuring and Reform Act of 1998 to improve the existing classification system for managers, which was considered to be especially problematic. In addition, the IRS did not establish pay policies and procedures to ensure managers are paid comparably to other IRS employees under the General Schedule Pay System or commensurate with their individual performance. Finally, the IRS did not sufficiently communicate the details of the new pay system or attempt to seek support from the affected managers.

WHAT TIGTA RECOMMENDED

The IRS should (1) reconsider the structure of its Internal Revenue Pay-for-Performance System for frontline managers by streamlining job classifications to be more broadly based on the nature of work performed and competencies; (2) reinstate the policy of providing managers who receive a Satisfactory or higher rating with the annual across-the-board pay adjustment; (3) consider alternate sources of funding for the performance-based salary pools and ensure the amounts dedicated for increases are sufficient to both reward top performers and compensate other managers equitably, based on their performance; and (4) offer employees an opportunity to express concerns about the new pay system and communicate more openly and timely with employees before implementing any new changes to employee compensation and benefits.

In their response to the report, IRS officials agreed with three of the four recommendations; they are conducting a third-party evaluation of the System and plan to make changes to the structure, funding, and communication process where appropriate. IRS officials disagreed with the recommendation to reinstate the policy of providing managers with the annual across-the-board pay adjustment. Management stated that the authority to provide managers with the annual across-the-board pay adjustment rests with the IRS Commissioner.

TIGTA recognizes the flexibility provided to the Commissioner to set pay increases under the *Office of Personnel Management Criteria* and is not suggesting this authority be removed. TIGTA also recognizes the Commissioner's desire to grant pay raises with meaningful distinctions for higher rated managers. TIGTA believes the Commissioner can do both without decreasing the morale of managers rated as Satisfactory by allocating amounts that would have been given for within-grade step increases and quality step increases to the higher rated managers.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2007reports/200710106fr.pdf>.

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